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Supreme Court of the United States

OCTOBER TERM, 1946

No. 371

UNITED STATES NATIONAL BANK IN JOHNSTOWN and FIRST NATIONAL BANK OF SOUTH FORK,
Petitioners,

vs.

CHASE NATIONAL BANK OF THE CITY OF NEW YORK and LESTER LARIMER, *Trustee.*

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT FOR THE THIRD CIRCUIT.

BRIEF OF RESPONDENT IN OPPOSITION

WILLIAM DEAN EMBREE,
Counsel for Respondent.

MILBANK, TWEED, HOPE, HADLEY & MCCLOY,
Attorneys for Respondent.

THOMAS P. FARLEY,
Of Counsel.

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Opinions Below

The opinions of the Circuit Court of Appeals, Third Circuit, are reported in 155 F. (2d) 755.

The opinions rendered by the District Court are reported in 56 F. Supp. 190 and 61 F. Supp. 151.

Statement

A voluntary petition of bankruptcy was filed herein on June 10, 1925 by Harvey C. Stineman, the bankrupt, and the matter referred to a Referee. Among the assets of the estate was an undivided one-sixth interest in certain coal lands. The petitioners claim that the value of this asset

was appraised and fixed at $90,000 (Petrs.' br., pp. 2, 15). The record, however, fails to disclose that any such appraisal or valuation was made.

On January 8, 1927 petitioner, United States National Bank in Johnstown (herein referred to as the Johnstown Bank) filed a claim in the amount of $10,000, reciting as security the lien of a judgment it had procured prior to the filing of the petition (10a). A similar claim was filed by First National Bank of South Fork (herein referred to as the South Fork Bank) on June 29, 1936 in the amount of $18,463.45 (19a). The latter was based upon three judgments rendered against the bankrupt in the respective amounts of $11,290, $5,520 and $1,653.45 (20a). It is only on the $11,290 judgment that the South Fork Bank has asserted a lien upon the real property of the bankrupt.

Thereafter and on July 14, 1932 the Johnstown Bank filed a claim designated as an "amended liquidated claim" for $13,685 (12a). The difference in the amount of its original claim and the "amended liquidated claim", in the sum of $3,685 represented interest accruing after bankruptcy on the aforementioned judgment of $10,000. The question of the right to accrued interest has been determined and is not involved here.

The "amended liquidated claim" contains no recital of any security and appears to be a general claim which takes the place of the original claim.

Since the filing of its claim the Johnstown Bank has asserted that it has a judgment lien upon the real property of the bankrupt including the coal lands above referred to and has received and accepted the proceeds of the sale of certain of the bankrupt's real property (60a). This bank has also participated in the distribution of the general assets of the estate and received and accepted seven dividends on the full amount of its "amended liquidated claim", to wit, on $13,685 (60a). It is undisputed that its alleged judgment lien was never valued in this proceeding.

The South Fork Bank likewise failed to have the value of its alleged lien fixed and also participated in the distribu-

tion of the general assets of the bankrupt's estate, receiving seven dividends on the full amount of its $18,463.45 claim (17a).

General claims in this estate amount to approximately $225,000. Among these is the claim of respondent, The Chase National Bank of the City of New York (herein referred to as Chase Bank) in the amount of $55,231.98. This claim was allowed on May 14, 1935 and represents a reduction from the Chase Bank's original claim which was secured in part by collateral given by the bankrupt. The reduction was ordered upon exceptions filed by the Johnstown Bank and the South Fork Bank.

Questions Presented

The primary question presented is whether or not a judgment lien creditor waives his security where a claim for the full amount of his debt is filed and dividends accepted thereon without first having the alleged security valued. A secondary question is also presented as to whether a general creditor, by remaining silent after payment of dividends to judgment lien creditors on the full amount of their claims, is estopped from asserting a waiver of security by such judgment lien creditors.

The questions presented at pages 5 and 6 of the petition are based upon the false assumptions: (1) that all the creditors in this proceeding, secured and unsecured, entered into an agreement permitting the judgment lien creditors to retain the security of their liens without having such liens valued and at the same time participate with general creditors in the distribution of dividends on the full amount of their claims and (2) that the judgment lien creditors were induced to forbear and refrain from enforcing their lien and thereby created a substantial benefit to the general creditors. The record discloses no such agreement nor inducement to forbear. On the other hand, it discloses that the judgment lien creditors elected a remedy and thereby waived their security.

POINT I

There is no question of local law nor general law, nor any important question of federal law involved in this record, and no special reasons are shown by the petition why a Writ of Certiorari should be granted.

In this case there are no special or important reasons calling for the exercise of this Court's power of supervision through its Writ of Certiorari. None of the reasons indicated in Rule 38 of the Rules of this Court will be found in the record presented for review in this case.

There is no important question of local law involved nor any important question of general law, nor is there any important question of federal law which could be settled in this case if the Writ of Certiorari should be granted. There is likewise no conflict between the decision sought to be reviewed and any prior ruling of this Court, nor has there been any departure from the accepted and usual course of proceedings calling for an exercise of this Court's power of supervision.

In *In Re O'Gara Coal Co.*, 12 F. (2d) 426, a petition for a Writ of Certiorari was made to this Court seeking a review of a similar question as here presented relating to waiver of security by a creditor. This Court denied that application 271 U. S. 683.

Although the opinion of the Circuit Court sought to be reviewed specifically refers to the provisions of the Bankruptcy Act which apply to the distribution in this proceeding, the petitioners have failed both to point out any error therein or discuss the applicable provisions of such Bankruptcy Act. Petitioners likewise failed to show that a construction of such provisions by this Court is necessary or desirable.

POINT II

Where a creditor files a claim for the full amount of his debt and accepts dividends thereon, he waives any security which he might have had.

Section 65 of the Bankruptcy Act (11 U. S. C. A. 105) provides in part as follows:

> "a. Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured."

Section 57h of the Bankruptcy Act (11 U. S. C. A. 93h), on the other hand, permits secured creditors to have the value of their securities determined, the amount of such value credited upon their claims and dividends paid, *only* on the unpaid balance. That Section reads as follows:

> "h. The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court."

Thus the Bankruptcy Act does not permit a secured creditor to claim ownership of a charge against some specific fund or property on which he could release all or part of the amount of his claim and at the same time look to the general assets of the estate to liquidate the same debt. It is fundamental that the security must first be valued and credited before participation in distributions from the general estate are permitted and dividends may be paid only on the balance. In *H. Muehlstein & Co.* vs. *Hickman*, 26 F. (2d) 40, the Court said at page 44:

"In bankruptcy, of course, the claimant can recover only in the manner, and to the extent, prescribed by the act."

There is no dispute here that the Johnstown or South Fork Banks failed to have the value of their alleged security determined as provided by Section 57 of the Bankruptcy Act. By accepting the dividends therefor on the full amount of their claims, these two banks elected to take their place with unsecured creditors and share ratably with them. The effect of such election is a waiver of security.

In *In Re O'Gara Coal Co.*, 12 F. (2d) 426, cert. den., 271 U. S. 683, the Court said:

> "'The provision and purpose of the law is that those having security shall, in the manner provided by the statute, get the benefit of that security, but must do so at the expense of reducing the claim upon which they are entitled to participate as a general creditor in the funds of the estate, * * *. When one has two inconsistent remedies and elects to pursue one, he abandons the other." (p. 429)

In *In re Fisk & Robinson*, 185 Fed. 974, the Court held that the filing of a claim against a bankrupt's estate and the receipt of dividends thereon is a waiver of the creditor's security. There the Court said at page 975:

> "It is quite true that to file a claim is to waive security (Ansonia Brass & Copper Co. *v.* Babbitt, 74 N. Y. 395), for one may not collect dividends upon the whole debt and then take security upon a part. The rule is similar to that which confines a broker's customer to his election between his claim and his stocks. Re Berry, 174 Fed. 409, 98 C. C. A. 360. Had the claimant actually received dividends, the question would be clear. Nor does it matter, I think, that the funds are separate as the referee suggests; for the waiver operates, whether the claim to the security arises in the bankruptcy court or out of it. Ansonia Brass & Copper Co. *v.* Babbitt, supra. It is enough that the claimant should have elected not to assert his security, and that election would be signified by going ahead upon a claim for full dividends."

In *In the Matter of Florence Pruner Young, Bankrupt*, 9 Am. B. R. (N. S.) 544, the Court refused to permit an amendment of an unsecured claim after the receipt of a dividend thereon to show that it was secured on the ground that the creditor, having pursued the full amount of its claim and having been paid dividends thereon, had elected its remedy. The Court said at pages 545-546:

> "In the instant case, in addition to the filing of the proof of claim of an unsecured debt, the claimants specifically stated '(5c) That no note has been received nor judgment recovered therefor (except assignment of note of bankrupt favor Grove City State Bank)'. A dividend of 20 per cent was declared on July 10, 1926, and the claimant in the instant case received and retained his 20 per cent. A final dividend also has been declared, after which time the claimant seeks by amendment to change his claim into a secured or preferred claim. There is nothing on the record which shows that the claimant made his proof of claim as an unsecured debt without knowledge of all the facts, or even in ignorance of his legal rights to prove as preferred claims the judgments which were assigned to him. From all that appears upon the record at the present time, he deliberately elected to pursue his remedy as a general claimant, acted upon that election, and has received part of the fruits of that election in the 20 per cent dividend which has actually been paid to and received by him. We are of the opinion that he should not now be permitted to change that election.
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> "In the instant case, the creditor elected the remedy which he would pursue for the amount of this claim; his election was acted upon; and he was paid dividends in accordance with the claim which he deliberately made. There are no facts set forth in his petition to amend which would justify the allowance, under these circumstances, of the amendment asked."

In *First National Bank* vs. *Exchange National Bank*, 179 App. Div. 22, the Appellate Division held that the ac-

ceptance of dividends was a waiver of security. The Court said (pp. 32-33):

> "The bank, in what it did in the Bankruptcy Court, elected to waive any lien and security it had, and prove its claim as an unsecured creditor, and the bank by accepting the dividends ratified the acts of its cashier in waiving the security and proceeding to prove its claim as an unsecured one, and it must be held that when the bank proved its claim under the three Clark notes in the Bacon bankruptcy proceedings as an unsecured claim, it waived any security it had upon the pledged stocks in question, and its lien thereon became extinguished. * * * Defendant Exchange National Bank, having elected its remedy by filing a claim and accepting a dividend as an unsecured creditor of Francis Bacon, being in possession of all the facts at the time it filed its claim, must be deemed bound by its action in electing its remedy, and has no claim or lien upon the stocks in question." (*Matter of Bloss*, 4 Nat. Bank Rep. 147; Heard *v.* Jones, 15 id. 402; Collier Bankruptcy [8th ed.], 598.)"

Although the judgment in the above case was modified on appeal, the quoted ruling was approved (226 N. Y. 633).

To the same effect:

In re Burr Mfg. & Supply Co., 217 Fed. 16;

In the Matter of Cann, 47 F. (2d) 661;

In re Ballance et al., 219 Fed. 537;

Cumberland Glass Mfg. Co. vs. *De Witt and Co.*, 237 U. S. 447;

Merchants' Nat. Bank of Syracuse vs. *Comstock*, 55 N. Y. 24;

Elston vs. *Rusch*, 229 N. W. 503 (Mich.);

Hewitt vs. *Hayes*, 91 N. E. 332 (Mass.);

R. L. Davies & Co. vs. *Blomberg*, 117 S. E. 497 (No. Carolina);

Hunt vs. *Holmes*, Fed. Cas. No. 6890;

Ex parte Morris, Fed. Cas. No. 9823.

In *Elston* vs. *Rusch*, *supra*, the Court after holding that a secured creditor is only entitled to a dividend on the amount of the claim in excess of the value of the security, said at page 504:

> "He may not file a claim for the full amount of the debt and receive a dividend based on it and at the same time recover all of the property in an appropriate suit. This not only would give claimant a preference over other creditors, but would be a fraud on the bankruptcy court."

The principle upon which the applicable doctrine proceeds is set forth in *Ansonia Brass and Copper Co.* vs. *Babbitt*, 74 N. Y. 395. There the Court of Appeals said at page 404:

> "The principle upon which this doctrine proceeds is that otherwise the proceeding would operate as a fraud upon or to the injury of other creditors, by enabling the secured creditor to obtain a dividend on his whole debt, out of the common fund, and at the same time have the benefit of the security, thereby producing inequality in the distribution between him and the other creditors."

POINT III

The Chase Bank is not estopped from asserting that the judgment lien creditors waived their security by acceptance of dividends.

Petitioners argue that the Chase Bank is estopped from contending that these judgment creditors waived their liens and assigns as reasons: (1) a participation agreement was made to which all creditors consented, (2) forbearance to foreclose their liens, and (3) Chase Bank permitted seven distributions to be made before demurring (Petrs.' br., p. 15, *et seq.*).

In answering this argument, the Circuit Court, after reference to the applicable provisions of the Bankruptcy

Act, and the lack of necessity for the course which petitioners claim was pursued, said:

> "The parties have demonstrated, as we have indicated, a complete disregard for the pertinent provisions of the Bankruptcy Act. Those provisions were not intended by Congress to apply only to certain individuals or under certain circumstances. Congress intended the provisions of the Act to be of universal application and to establish principles which Congress deemed necessary for the public good. The participants in Stineman's bankruptcy proceedings were bound by the law. National Bank in Johnstown and South Fork Bank may not receive the benefits of their securities and also be treated as general creditors to the full extent of their claims. They may not have the benefit of both positions and the liabilities and obligations of neither. Under the law an attempt to assert an estoppel against Chase or any other creditor which would effect such a result is futile." (p. 84a)

It is significant that petitioners neither discuss, criticize nor dispute this reasoning and refrain from making any reference to the pertinent provisions of the Bankruptcy Act. Their reason is obvious. They are aware that, contrary to the policy of such Act, they are striving to maintain "the benefits of both positions and the liabilities and obligations of neither".

It appears in the record (57a) that at a meeting of creditors called on December 31, 1929, the Trustee had a fund on hand representing the proceeds of a sale of real estate and of personalty. After an objection was made to pay the entire sum held to the first judgment creditor, Mr. Little, the attorney for the Trustee, made the following suggestion:

> "*By Mr. Little:* It was at the suggestion of myself, I think, that the order was made to pay this money to the first judgment creditor, with the thought that the two judgments which were liens on real estate being out of the way, we would have a clear sailing for prorated dividends thereafter. My clients, after the suggestion was made, decided that they could not acquiesce

in the suggestion, and requested me to file exceptions, which I was obliged to do. After discussing this with Mr. Keefe, and going over the matter generally, and after examining two of the leases from which the royalties were obtained in order to make up part of the fund for distribution, we suggested that under the law the estate should be divided into two items; one item showing funds arising wholly from real estate which does not include any of the leases or the funds from any of the leases; the other fund should be made up of all royalties, rentals, or dividends on stocks or bonds. The first fund to go to the first judgment creditor, the second fund to be divided pro rata among all the creditors."

It is submitted that the fact that it was suggested that the fund be divided into two items one representing the proceeds of the sale of realty and the other the proceeds from the sale of personalty clearly discloses an intention that the judgment creditors and general creditors were to be separately treated. This also appears from the fact that some of the creditors declined to acquiesce in the suggestion that the entire fund on hand be given to the first judgment creditor. Under the circumstances it cannot be said that the judgment creditors were to receive preferential treatment. Moreover, Mr. Little was also careful to state that the suggested method of distribution was to be "under the law". In other words, in accordance with sound and regular bankruptcy practice.

Contrary to petitioners' statements at pages 17 and 20 of their brief that the plan proposed was actually accepted and adopted by all creditors, the record fails to disclose that all or a majority of the creditors agreed to the method of distribution which petitioners now claim arose from Mr. Little's suggestion. Nor does it appear that the unusual plan now asserted to be the outgrowth of the above statement was submitted to a vote by all creditors or that an order sanctioning such a plan was ever entered. Such being the case, it cannot be contended that an agreement

was made whereby the judgment creditors were permitted to share in the distributions from the general estate.

Petitioners assert that their forbearance to foreclose benefited the general creditors. Wherein a benefit was derived, however, was not established. Throughout their brief they speculate upon what would have happened had they foreclosed their lien. The weakness of their argument is evidenced by the inconsistent positions they strive to maintain. Asserting that the real property was valued at $90,000 and their claims amounted to $28,500, they say at page 15 of their brief "This made it apparent that there might be a substantial equity in such asset for the benefit of creditors". Petitioners then contradict this statement at page 23 of their brief by saying "if the lien creditors had foreclosed upon their liens and securities, there would have been little, if anything, left for general creditors". It is just as reasonable to speculate as to the benefits the general creditors might have derived had there been a foreclosure of the judgment liens. They would at least have had the opportunity, through the Trustee or a committee, to bid for the property free from the liens and perhaps operate it at a profit for their own benefit. Speculation, it is submitted, does not sustain petitioners' contention.

The failure of the Chase Bank or any other creditor to question the acceptance of dividends by the judgment creditors until after several were paid does not create or show laches or estoppel. Such a contention overlooks the fact that an election was made by the petitioners. It also overlooks the fact that the unsecured creditors had a right to assume that the Johnstown and South Fork banks were relying upon the general fund for the payment of their claims. Estoppel operates against the one who made the choice and upon which the others had a right to rely. Silence on the part of the unsecured creditors cannot change the fact that an election was once made. The election having once been made is now final and binding upon the judgment creditors. *In Re O'Gara Coal Co.*, 12 F. (2d) 420, cert. den. 271 U. S. 683; *In Re Fiske & Robinson*, 185 Fed. 974; *In Re Young*, 9 Amer. B. R. (N. S.) 544.

It is respectfully submitted that petitioners' application for a Writ of Certiorari be denied.

WILLIAM DEAN EMBREE,
Counsel for Respondent.

MILBANK, TWEED, HOPE, HADLEY & MCCLOY,
Attorneys for Respondent.

THOMAS P. FARLEY,
Of Counsel.